

ISSUE DATE: July 2, 1999

DOCKET NO. E,G-002/S-98-1625

ORDER APPROVING AMENDMENT TO CAPITAL STRUCTURE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey  
Joel Jacobs  
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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Petition of Northern States  
Power Company to Amend Its Approved 1999  
Capital Structure

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**PROCEDURAL HISTORY**

On December 10, 1998, the Commission issued an Order approving Northern States Power Company's (NSP's) 1999 consolidated capital structure.<sup>1</sup>

On April 30, 1999, NSP requested an amendment to its approved 1999 capital structure.

On May 28, 1999, the Department of Public Service (the Department) filed comments recommending approval of NSP's request.

On June 14, 1999, NSP submitted a revised request for approval of an amendment to the Company's 1999 capital structure.

On June 23, 1999, the Department filed supplemental comments.

On June 24, 1999, the matter came before the Commission for consideration.

**FINDINGS AND CONCLUSIONS**

**I. NSP'S CURRENT APPROVED CONSOLIDATED CAPITAL STRUCTURE**

In its December 10, 1998 Order, the Commission approved NSP's consolidated capital structure with a total capitalization not to exceed \$5,802 million during calendar year 1999, and an additional contingency of \$237 million (for a total capitalization of \$6,039 million). The Commission approved an equity ratio for the Company of 45.0 percent, with a contingency range of plus or minus 10% (40.5% - 49.5%). NSP's approved contingency for short-term debt was capped at 10% of total capitalization. NSP was required to inform the Commission if it

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<sup>1</sup> NSP's consolidated capital structure includes debt and equity of the total company--both the regulated utility and the nonregulated entity.

anticipates exceeding the contingency limits in 1999 for a period longer than 60 days.

## **II. THE COMPANY'S REQUEST FOR AN AMENDED CAPITAL STRUCTURE**

### **A. Background**

In letters to the Commission, NSP stated that its non-regulated subsidiary, NRG Energy, Inc. (NRG) will soon close on a series of acquisitions of generating plants in the eastern United States. The acquisitions will result in approximately \$650 million of additional short- and long-term, non-recourse debt<sup>2</sup> being reflected on NRG's balance sheet.<sup>3</sup>

In the normal course of events, NSP would avail itself of the brief window to buy property such as these generating plants, then almost immediately look for an investor-partner to buy down NSP's share to less than 50%. Under accounting rules, when NSP's ownership fell to less than 50% the non-recourse debt would not appear on either NSP's or NRG's balance sheet.

In this particular case, however, NSP's plan to acquire the plants intersected with the Company's ongoing negotiations to merge with New Century Energies, Inc. (NCE). Because NSP intends to use "pooling of interests" accounting for its merger with NCE, NSP cannot at this time divest of any significant portion of its assets. Accounting rules will therefore require the \$650 million project debt to be reflected on NSP's balance sheet. Addition of this further non-recourse debt will cause the Company to exceed its total capitalization limit and to fall out of compliance with its approved common equity ratio.

NSP's ongoing negotiations with NCE also resulted in an increase to its short-term debt balance. Because the Company's ability to issue securities was restricted during merger discussions with NCE, NSP used short-term debt in February, 1999, to replace \$200 million of maturing first mortgage bonds. Second quarter dividend and property tax payments and NRG's financing of various project closings further increased the Company's short-term debt level to approximately \$825 million during June, 1999. Once NSP's permanent debt financing is complete (by the end of June), the Company expects its short-term debt to be approximately \$450 million. Increasing the short-term debt level to 15% of the requested new total capitalization would provide the Company flexibility for its short-term financing needs for the remainder of 1999.

### **B. The Request**

NSP asked approval of the following amendments to its previously approved 1999 capital structure:

- exclude all non-recourse debt from the calculation of total capitalization and common equity ratio

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<sup>2</sup> The debt is non-recourse to NSP and NRG because it is project financing. In the event the project fails, the lender only has recourse to the project--not to NSP or NRG--for recovery of the debt.

<sup>3</sup> NSP already has \$100 million in non-recourse debt on its balance sheet.

- revise total capitalization to \$6,965 million, consisting of the forecasted 1999 year-end total capitalization of \$5,965 million, with an additional contingency of \$1,000 million
- increase short-term borrowing levels to 15% of the amended total capitalization of \$6,965 million

In the event the Commission rejects NSP's proposal, the Company proposed the following alternative revision to its capital structure:

- revise total capitalization to \$7,715 million, consisting of forecasted year-end total capitalization of \$6,715 million, with an additional contingency of \$1,000 million
- expand the common equity ratio contingency from plus or minus 10% to plus or minus 15%
- increase short-term borrowing levels to 15% of the amended total capitalization of \$7,715 million

The Company offered the following reasons the Commission should pick the first alternative:

- the non-recourse debt is not an obligation of either NSP or NRG and should not be included in calculations of total capitalization or common equity ratio
- inclusion of the non-recourse debt in NSP's capital structure would distort the view of NSP's credit quality and conflict with the manner in which the Company manages its capital structure
- the non-recourse debt would not be included in the capital structure for the regulated entity for purposes of Minnesota rate-making
- inclusion of the non-recourse debt would be inconsistent with the approach used by bond-rating agencies to assess the Company's credit quality

### **III. THE DEPARTMENT'S COMMENTS**

The Department supported the Company's first proposed alternative for revision of its capital structure. The Department noted that the Company is going through a significant and unique event--a merger with another entity. The Department believed that the Company's issues regarding non-recourse debt and short-term debt are tied to the merger; the requested adjustments to these factors could be considered necessary, one-time accommodations.

The Department stated that it continued to believe that NSP's low equity ratio and high debt ratio are justified only in the short-term and should not be sustained. Given NSP's stated intention to improve its capital structure and to maintain a long-term capital structure that would maintain its AA bond rating, the Department believed that NSP's proposed revised capital structure (with the exclusion of non-recourse debt) is acceptable.

#### **IV. COMMISSION ANALYSIS**

Prior to the issuance of any securities, utilities must petition for and receive Commission approval of their capital structures. The Commission generally requires utilities to submit their capital structure filings on an annual basis. Minn. Rules, part 7825.1100. The capital structure review allows the Commission to analyze the utility's overall financial soundness and the degree and type of financial risk.

The Commission recognizes that events can affect a utility's capital structure in unforeseen ways. Particularly in this era of heightened competition and rising interest in new forms of utility structure, a company's need to respond quickly may result in a temporary need to shift debt and equity ratios. The Commission therefore typically builds some leeway into the capital structure approval process, so that utilities will have the necessary financial flexibility to respond to unforeseen events and fast-emerging financial opportunities. The contingency parameters built into approved capital structures are meant to accommodate utility response to unanticipated, but reasonable, changes in financial circumstances.

In the current case, NSP's anticipated merger with NCE is a significant event that falls beyond the scope of the typical "unforeseen circumstances" factored into the Company's last capital structure approval process. The merger process has had two results that affect the current proceeding: the intended use of the "pooling of interests" merger accounting method has caused an additional \$650 million in project debt to be reflected on NSP's balance sheet; and merger negotiations have resulted in an increase to the Company's short-term debt balance. In its analysis, the Department concluded that the merger-sparked events were beyond the scope of typical unforeseen circumstances, but not beyond the scope of reasonable events in merger situations. The Department recommended granting the Company the necessary capital structure flexibility to accommodate company operations during this unique period.

The Commission agrees with the Department that granting NSP capital structure relief in this case will provide the Company the necessary financial flexibility without jeopardizing its overall financial health. On the other hand, the fact that the company is facing such a significant financial event as a merger means that approved shifts in financial structure may not be short-lived; the challenges faced in any merger process are unlikely to be resolved swiftly. The Commission must therefore choose a relief method that meets the company's financial need while maintaining the greatest possibility regulatory stability.

The Commission finds that NSP's alternative capital structure request--a greater increase in total capitalization and short-term debt levels without the exclusion of non-recourse debt--would provide the Company the necessary flexibility while maintaining consistency with the accounting principles upon which regulatory oversight depends. Including non-recourse debt in the capital structure analytical process is consistent with Generally Accepted Accounting Principles (GAAP). Maintaining cohesion with GAAP is a desirable regulatory goal which allows consistent analysis upon which regulators and stakeholders alike can rely.

NSP's second capital structure alternative is also preferable to the first because its higher total capitalization and debt levels will allow the Company sufficient flexibility to choose its own financial opportunities (within Commission-prescribed limits) as it faces the financial, legal and regulatory hurdles associated with its current merger process.

For these reasons, the Commission will approve NSP's alternative capital structure amendment request: the increase of total capitalization to \$7,715 million; expansion of the common equity ration variance for the remainder of 1999 to plus or minus 15% (38.25% to 51.75%); and increase of the short-term debt level to 15% of the amended total capitalization of \$7,715 million.

**ORDER**

1. The Commission approves the following amendment to NSP's 1999 approved capital structure: the increase of total capitalization to \$7,715 million; expansion of the common equity ration variance for the remainder of 1999 to plus or minus 15% (38.25% to 51.75%); and increase of the short-term debt level to 15% of the amended total capitalization of \$7,715 million.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

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